

**Internal Revenue Service**

**Department of the Treasury**

Washington, DC 20224

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date:

NOV 12 1992

Employer Identification Number: [REDACTED]

Form: 1120

Tax Years: 1988-Present

Dear Applicant:

This is a final adverse ruling as to your exempt status as an organization described in section 501(c)(3) of the Internal Revenue Code.

This ruling is made for the following reason(s):

You are not a cooperative hospital service organization described in section 501(e) of the Code because you are not organized and operated solely to perform on a centralized basis one or more services described in section 501(e)(1)(A) for two or more exempt hospitals. Further, a substantial part of your activities consists of providing commercial-type insurance. Consequently, section 501(m) precludes your exemption as an organization described in section 501(c)(3). You are not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. You are operated for a substantial non-exempt commercial purpose. Furthermore, you are a feeder organization within the meaning of section 502.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file federal income tax returns on the above form. Based on the financial information you furnished, it appears that returns should be filed for the tax years shown above. You should file these returns with your key District Director for exempt organization matters within 30 days from the date of this letter, unless a request for an extension of time is granted. Returns for later tax years should be filed with the appropriate service center as indicated in the instructions for those returns.

[REDACTED]

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate a suit in the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia before the 91st day after the date that this ruling was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment.

Processing of income tax returns and assessment of any taxes due will not be delayed because a declaratory judgment suit has been filed under section 7428.

In accordance with section 6104(c) of the Code, the appropriate State officials will be notified of this action.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown above.

Sincerely,

(signed) [REDACTED]

[REDACTED]  
Director, Exempt Organizations  
Technical Division

[REDACTED]  
[REDACTED]  
[REDACTED]  
16 APR 1992

Employer Identification Number: [REDACTED]  
Key District: Atlanta

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code (hereafter referred to as the Code), as an organization described in section 501(e). Based upon the information presented, we have determined that you do not qualify for exemption.

Information submitted indicates that you were formed on [REDACTED], pursuant to the rules of the [REDACTED] and [REDACTED], specifically as provided by Section [REDACTED], Statutes. Your purpose is to provide workers' compensation benefits to your hospital members. Your members are comprised of unrelated hospitals which are either governmental tax district hospitals or hospitals which have previously been recognized as exempt under section 501(c)(3) of the Code. You represent that your members have pooled their assets to fulfill their obligations to employees under the [REDACTED] Workers' Compensation Act with the effect of reducing insurance costs through minimizing claims costs, service costs, and safety program costs. Furthermore, you indicate that excess funds for liabilities are returned to members and any inadequate funding is provided by assessment of members. Your sources of financial support are member contributions and investment income.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3) of the Code. This section also provides, in pertinent part, that an organization described in subsection (c) shall be exempt from taxation unless such exemption is denied under section 502.

Section 501(c)(3) of the Code describes, in part, organizations organized and operated exclusively for charitable purposes.

Section 501(e) of the Code provides that an organization shall be treated as an organization organized and operated exclusively for charitable purposes if:

(1) such organization is organized and operated solely - (A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group basis), warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and (B) to perform such services solely for two or more hospitals each of which is (i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a), (ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or (iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8 1/2 months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501.

Section 1.501(e)-1(a) of the Income Tax Regulations provides that section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization. To qualify for tax-exempt status, the organization must (1) be organized and operated on a cooperative

basis, (2) perform, on a centralized basis, only one or more specifically enumerated services which, if performed directly by a tax-exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption, and (3) perform such service(s) solely for two or more patron-hospitals.

Section 1.501(e)-1(c)(1) of the regulations lists the permissible services: data processing, purchasing (including the purchasing and dispensing of drugs and pharmaceuticals to patron-hospitals), warehousing, billing and collection, food, clinical (including radiology), industrial engineering (including the installation, maintenance and repair of biomedical and similar equipment), laboratory, printing, communications, record center, and personnel (including recruitment, selection, testing, training, education and placement of personnel) services. An organization is not described in section 501(e) if, in addition to or instead of one or more of these specified services, the organization performs any other service.

In HCSC-Laundry v. United States, 450 U.S. 1 (1981), the Supreme Court held that a cooperative hospital service organization cannot qualify for exemption from federal income taxation as a charitable organization under section 501(c)(3) of the Code, but instead may qualify only if it performs one of the services listed in section 501(e)(1)(A). The Court reasoned that since laundry service was deliberately omitted from the list of services in subsection (e), HCSC-Laundry is not entitled to tax-exempt status because it is organized to provide laundry services for exempt hospitals and an exempt ambulance service. As stated by the Court, "[I]t seems to us beyond dispute that subsection (e)(1)(A) of section 501, despite the seemingly broad general language of section (c)(3), specifies the types of hospital service organizations that are encompassed within the scope of section 501 as charitable organizations." 450 U.S. at 8.

In order to qualify as a cooperative hospital service organization under the provisions of section 501(e) of the Code, an organization must be organized and operated solely to perform one or more of the services specified in section 501(e)(1)(A) of the Code. As the Supreme Court noted in HCSC-Laundry v. United States, supra, Congress exclusively addressed the exemption of cooperative hospital service organizations under section 501(e). Each activity listed in section 501(e)(1)(A) is limited to those activities "which, if performed directly by a tax-exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption ..." H.R. Rep. No. 1533, 90th Cong., 2d Sess. (1968), 1968-2 C.B. 801, 814.

Section 501(m) of the Code denies exemption under section 501(c)(3) to organizations if a substantial part of their activities consists of providing commercial-type insurance.

Section 501(m) of the Code does not define "commercial-type insurance." The legislative history, however, says commercial-type insurance generally is any insurance of a type provided by a commercial insurance company. H.R. Rep. No. 426, 99th Cong., 1st Sess. 665 (1985). The legislative history explains the purpose underlying section 501(m)'s enactment, as follows:

The committee is concerned that exempt charitable and social welfare organizations that engage in insurance activities are engaged in an activity whose nature and scope is so inherently commercial that tax exempt status is inappropriate. The committee believes that the tax-exempt status of organizations engaged in insurance activities provides an unfair competitive advantage to these organizations. The committee further believes that the provision of insurance to the general public at a price sufficient to cover the costs of insurance generally constitutes an activity that is commercial.

Id., at 664

Rev. Rul. 78-41, 1978-1 C.B. 148 holds that a trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital and from which the hospital directs the bank trustees to make payments for claims qualifies for exemption under section 501(c)(3) of the Code. By serving as a repository for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust is operating as an integral part of the hospital. The trust is performing a function that the hospital could do directly.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States held that the presence of a nonexempt purpose, if more than insubstantial, would destroy tax exempt status as a charitable organization.

The information you have submitted indicates that you were established for the express purpose of providing workers' compensation insurance to your members. You were established to allow your member organizations to share the risk of liability and assume the financial burden of any covered loss. You, not your members have the obligation to pay claims. Under state law certain qualifying organizations are entitled to use this alternative to participating in the state sponsored workers' compensation fund.

While section 501(e)(1)(A) was amended by the Technical and Miscellaneous Revenue Act of 1988 to permit hospital service organizations to purchase insurance on a group basis, your activities are not covered under this amendment since rather than purchasing insurance on a group basis, you instead operate a self-insurance fund. This activity is a trade or business conducted by you for unrelated hospitals rather than a centralized service for patron-hospitals. You are therefore taxable under section 502 as a feeder organization.

In this case, your essential purpose is the shifting and distribution of risk among the unrelated members of the organization so that insurance coverage can be provided at costs that are lower than those which can be obtained from conventional sources. Moreover, the insurance provided by you is indistinguishable from that offered by commercial insurance companies. Therefore, because a substantial part of your activities consist of providing commercial-type insurance, section 501(m) of the Code would ordinarily prevent the recognition of your organization as an organization described in section 501(c)(3).

The legislative history of section 501(m) of the Code suggests that, from its inception, it was designed to apply to those organizations whose exemption was predicated on their "providing commercial-type insurance" as opposed to those organizations whose exemption was based on some other charitable or social welfare purpose but who sold insurance as an unrelated trade or business and were taxed accordingly. Thus, the Joint Committee Explanation notes at pages 583-584 that, notwithstanding the fact that the provision of insurance benefits by an organization is generally considered a commercial activity that does not meet the requirements for tax exempt status, at least one organization which provides life insurance and annuities to employees of tax-exempt educational institutions was recognized as a charitable organization by the Service, and a major health insurance provider was treated as a social welfare organization. The Joint Committee Explanation (at page 584) states that Congress believes that tax exempt status under these circumstances is inappropriate.

In this case, your only reason for existence is the provision of insurance described above. Much like the organizations at which section 501(m) of the Code was directed, you have no independent basis for exemption as a charitable or social welfare organization.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption from federal income tax under section 501(c)(3) of the Code as a cooperative hospital service organization under section 501(e), because you are not operated solely to perform, on a centralized basis, one or more specifically enumerated services for an exempt

hospital. Moreover, section 501(m) precludes your exemption under section 501(c)(3). You are, therefore, required to file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to that office. Also, the appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely,

(signed) [REDACTED]  
[REDACTED]

Director, Exempt Organizations  
Technical Division

cc: DD, Atlanta  
Attn: EO Group

cc: [REDACTED]

cc: [REDACTED]

[REDACTED]

[REDACTED]

4-9-92

4-9-92